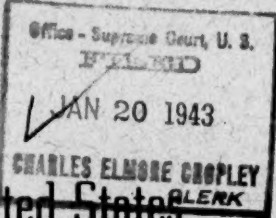


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IN THE

# Supreme Court of the United States



OCTOBER TERM, 1942.

No. **665**

H. F. METCALF, as Trustee in Bankruptcy of the Estate  
of F. P. NEWPORT CORPORATION, LTD., a corporation,  
Bankrupt,

*Petitioner,*

*vs.*

UNITED STATES OF AMERICA,

*Respondent.*

PETITION FOR WRIT OF CERTIORARI TO  
THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE NINTH CIRCUIT.

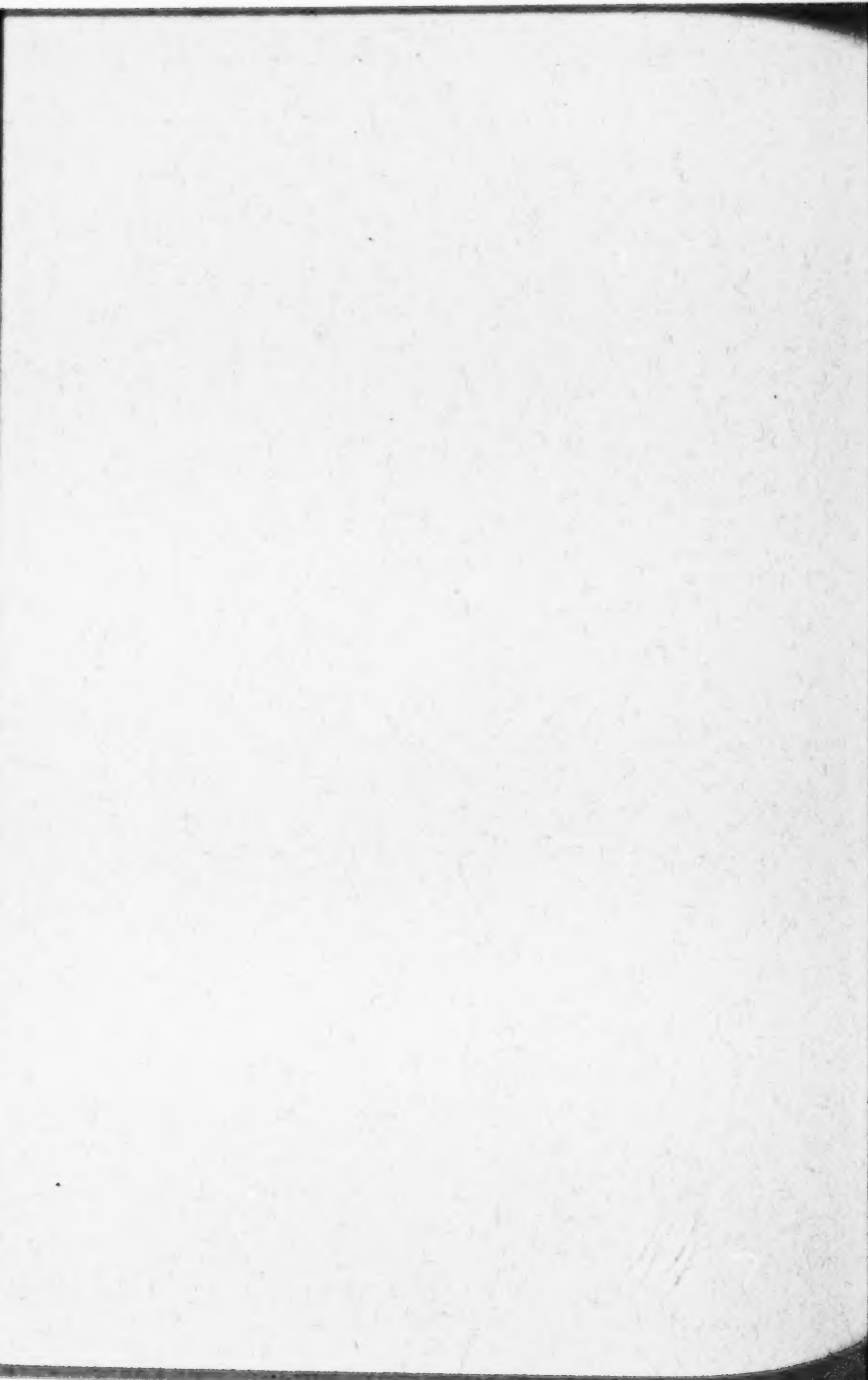
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*Counsel for Petitioner.*

Of Counsel:

ALLEN T. LYNCH.







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PETITION FOR WRIT OF CERTIORARI TO  
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*To the Honorable Supreme Court of the United States:*

H. F. Metcalf, as Trustee in Bankruptcy of F. P. Newport Corporation, Ltd., a corporation, Bankrupt, petitioner, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered November 23, 1942 [R. 211], reversing decision of the District Court of the United States, Southern District of California, Central Division. [R. 188-199.]

### Statement.

F. P. Newport Corporation, Ltd., was adjudicated a bankrupt on January 12, 1937. Petitioner was appointed Trustee on March 18, 1937, duly qualified as such Trustee and took possession of all the assets and properties of the bankrupt corporation, and as such Trustee during the years 1938 and 1939 engaged in the transactions hereinafter mentioned.

On July 22, 1940, Nat Rogan, as United States Collector of Internal Revenue for the Sixth Collection District of California, filed a claim in the bankruptcy proceedings, on behalf of the United States, for the sum of \$19,363.65, asserting thereby that said sum was payable by the petitioner as income taxes for the years 1938 and 1939, respectively. Objections to said claim were filed by petitioner, and a hearing thereon was had before the Referee in Bankruptcy to whom said proceeding had been referred by the District Court. These objections were sustained by the Referee, and the claim so filed by the Collector was disallowed. The Government took a review to the District Court, and the District Court on the 17th day of December, 1941, entered its order approving and affirming the Referee's order so disallowing said claim. An appeal from said order was taken by the Government to the United States Circuit Court of Appeals for the Ninth Circuit, and the latter court filed and entered its judgment on November 23, 1942, reversing said order of the District Court.

The bankrupt corporation was organized under the laws of the State of Delaware on December 2, 1929. Shortly thereafter it qualified to do business in the State of California, and thereupon entered upon and engaged



in the real estate business in said state prior to the filing of the petition in bankruptcy on March 19, 1935. In the conduct of such business it purchased large tracts of unimproved land, subdivided portions of them into city lots, installed essential public improvements, and endeavored to sell said subdivided and improved lots, and did in fact sell a great many of them. It also acted as the selling agent for other parcels of land owned by third persons. It conducted its business for the purpose of making a profit. [R. 31.]

The properties and assets coming into the possession of petitioner consisted of numerous parcels of real estate, both improved and unimproved, accounts receivable, promissory notes, bills receivable, and other tangible personal property. Record legal title to approximately ninety per cent of the real property so received by the Trustee stood in the name of Security-First National Bank of Los Angeles in trust and as security for an indebtedness owing said bank by the bankrupt, all as evidenced by a written declaration of trust. The indebtedness of the bankrupt to said bank at the date of bankruptcy was in excess of \$1,300,000.00. The bank filed a claim in the bankruptcy proceeding as an unsecured creditor in the amount of \$500,000.00, after crediting what it believed to be the value of the security held by it. Other claims filed against the bankrupt estate exceeded \$295,000.00, none of which have been paid by the petitioner either in whole or in part. [R. 32.]

For the purpose of avoiding a forced sale of the real properties covered by said trust and with the object of obtaining time within which to liquidate the properties at a fair value, a contract was made and entered into by and between the bank, the bankrupt and petitioner. A copy

of this contract, a supplement thereto and modifications thereof, is found in the record at pages 61 to 93, inclusive. This contract, supplement and modifications were approved by the Referee, the District Court and the Circuit Court of Appeals. (See *In re F. P. Newport Corporation, Ltd.*, 98 Fed. (2d) 453.)

This contract provided for the payment of the secured indebtedness of the bank in installments over a period of time and for the liquidation of the properties held by the bank as security for said indebtedness, upon terms and conditions satisfactory to the bankruptcy court. [R. 87.]

Among the properties title to which was so held by the said bank, were two parcels, one of three and the other of six acres, separated by an intervening three acre parcel belonging to third persons. During the pendency of the bankruptcy proceeding oil and gas wells were drilled and other wells were being drilled or about to be drilled on nearby lands which adjoined and surrounded said two parcels. It was feared by the Trustee and said bank that the operation of these wells would drain away the oil and gas believed by petitioner to underlie the same. Petitioner did not have sufficient funds to enable him to drill any oil or gas wells. By and with the approval of the Court he leased, on January 14, 1938, the two parcels of land to the Universal Consolidated Oil Company. Other lots in the same general area which were not of sufficient size to be covered by separate leases were included, with the approval of the court, in a community oil and gas lease wherein the Bankline Oil Company was lessee. [R. 33-34.]

The oil and gas lease to the Universal Consolidated Oil Company is contained in the record at pages 149 to 184, inclusive. By the terms of this lease the lessee was

granted the right to go upon the real property and prospect for oil and gas and other hydrocarbon substances, and to drill for, produce, extract, treat, remove and market oil, gas, natural gasoline and other hydrocarbon substances therefrom, and to maintain such tanks, boilers, houses, engines and other apparatus as might be necessary. The lessee was to pay to petitioner as Trustee in Bankruptcy a royalty of thirty-five per cent (35%) of the full market price of oil produced and saved, and a royalty of thirty-five per cent (35%) of the proceeds of the sale of gas or water. In addition thereto, a bonus was to be paid by the lessee of \$25,000.00 in cash and \$25,000.00 payable out of the first ten per cent (10%) of the gross production obtained from the demised premises. The lessee went upon the premises, drilled wells and extracted oil and gas, and paid to the Trustee during the year 1938 a cash bonus of \$25,000.00, an oil bonus of \$25,000.00, and oil and gas royalties of \$195,517.65. [R. 37.] All of these monies were paid to the Security-First National Bank of Los Angeles by the petitioner upon orders of the Court to cover (a) taxes assessed against the properties, (b) costs of engineering services for checking oil and gas production, (c) interest on the indebtedness owing said bank, (d) to apply on principal owing said bank. [R. 34.]

In 1939 oil and gas royalties paid to the Trustee amounted to \$206,333.36. These funds were likewise so paid to said bank to apply as above indicated. [R. 34.]

During the year 1938 petitioner, upon the approval of the bankruptcy court, sold a portion of the real properties of said estate for \$5,500.00, and during 1939 properties of the estate were sold for a total of \$19,450.00. All but twenty per cent (20%) of the amount so received was paid to said bank to apply on the indebtedness owing it;

the remaining twenty per cent (20%) was used by the Trustee to defray costs of sale and other expenses of administration.

Pending the sale of the real estate petitioner rented, mainly for agricultural purposes, portions of the real properties and received therefor during 1938 \$6,350.48 and during 1939 \$6,689.51. Other small collections were made by petitioner on account of the bankrupt's old accounts and from sales of miscellaneous personal properties. The total receipts of the Trustee from all sources were \$259,578.93 in 1938 and \$232,571.40 in 1939. After deductions allowed by the Commissioner of Internal Revenue the Commissioner determined that the net income for the year 1938 was \$87,066.42 and for the year 1939 was \$30,288.99. [R. 37-39.] Upon that alleged net income the tax in question was assessed.

Petitioner also granted easements and rights of way to the City of Los Angeles and the County of Los Angeles for street purposes, compromised with the approval of the Court certain claims made against the bankrupt, entered into agreements with the City of Long Beach concerning rights to oil and gas produced under the Universal Consolidated Oil Company lease hereinbefore mentioned pending determination of title disputes to the property covered by said lease, and made contracts with the Oilfield Testing & Engineering Company, Inc., for the checking of the oil and gas produced on the property. [R. 36.] The facts hereinbefore referred to were stipulated to, and the stipulation is found at pages 50 to 60, inclusive, of the record. The findings of fact of the Referee [R. 30-39] were in accordance with the stipulation of facts, so that the facts are without dispute, and are referred to in the opinion of the Circuit Court of Appeals. [R. 204-210.]

### **Jurisdiction.**

The judgment of the Circuit Court of Appeals was entered on November 23, 1942. The jurisdiction of this Court is invoked under Judicial Code Section 240 (a), as amended by the Act of February 13, 1925, Chapter 229, 43 Stat. 938 (28 U. S. C. A. Section 347), and Section 24, subdivision (c) of the Bankruptcy Act.

### **Statute Involved.**

The statute here involved is Section 52 of the Revenue Act of 1938, c. 289, 52 Stat. 447, reading as follows:

#### **"Sec. 52. Corporation Returns.**

"Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title and such other information for the purpose of carrying out the provisions of this title as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control."

Section 52(a) of the Internal Revenue Code (U. S. C. 1940 ed., Title 26, Sec. 52) is identical with the above quoted section.

### Question Presented.

The sole question presented is whether or not petitioner is required to pay out of the assets of the bankrupt estate an "income tax" on the receipts had by him as such Trustee and resulting from the transactions hereinbefore mentioned.

### Reasons Relied on for the Allowance of the Writ.

1. The Referee in Bankruptcy who initially passed upon the claim presented or filed by the Government held that the acts and transactions had and performed by petitioner were had, done and performed by him pursuant to the provisions of the Bankruptcy Act and in performance of his duties as such Trustee, and that in performing said acts and carrying out said transactions he was not operating the property or business of the bankrupt corporation within the meaning of the terms and provisions of said Section 52(a) of the Internal Revenue Code, and therefore was not required to pay any tax upon his said receipts.

The findings of the Referee were full and complete and were approved and affirmed by the District Court upon review. The Circuit Court of Appeals reversed the District Court, concluding that the acts and transactions of petitioner constituted "operating" the property within the meaning of the statute in question.

The conclusion of the Circuit Court of Appeals is in direct conflict with the decision of the Circuit Court of Appeals of the Second Circuit, in the *Matter of Heller*,

*Hirsh & Co., Bankrupt*, 258 Fed. 208 (43 A. B. R. 525) (1919), wherein the Circuit Court refers to the opinion of the Referee, which is in part as follows (page 211):

"The language used in subdivision (c) shows that the subdivision was not intended by Congress to apply in the case of receivers or trustees in bankruptcy or assignees who merely marshaled and distributed the assets of an insolvent corporation among its creditors.

"In terms subdivision (c) applies only in cases where receivers or trustees in bankruptcy or assignees 'are operating the property or business of corporations' and thus may be in the receipt of a 'net income' as defined in the prior sections of the Act. I regard the quoted words as of marked significance.

"To my mind the subdivision was inserted in the Act to meet the specified case of the profitable operation of the business of a corporation by the officers mentioned; for instance, the operation of the business of a railroad corporation by receivers or the operation of the business of a manufacturing corporation by a trustee in bankruptcy, etc.

"In either of such cases it is quite possible that the operation of the business might result in a net income, a result which Congress sought very properly to reach; see *Scott v. Western Pacific R. R. Co.*, 246 Fed. 545, 548, 158 C. C. A. 515 (C. C. A. 9th Circuit, 1917). I repeat my conviction that in enacting subdivision (c) Congress had in mind the definite case so aptly described by the language used, and not the case of the officers mentioned when acting merely as liquidators."

2. In its decision the Circuit Court of Appeals has decided an important question of bankruptcy law which

has not been but should be settled by this Court. The decision of the Circuit Court of Appeals, if permitted to stand, will result in all trustees in bankruptcy being subjected to the payment of an income tax where they take possession of properties and pending their sale receive rentals for the use of any portion thereof or enter into any lease or contract for the production by another of oil or gas or other hydrocarbon substances from a parcel thereof, all of which is contrary to the intent and purpose of the statute in question, as it was not intended by this statute to subject a trustee to the payment of income tax upon receipts derived by him as the result of his performance of his duties as such trustee in marshaling, preserving and liquidating the assets of the estate.

A diligent search has been made, but petitioner has not found any decision of this Court construing the Act in question as applied to a trustee in bankruptcy.

### Conclusion.

For the foregoing reasons it is respectfully submitted that this Petition should be granted.

H. F. METCALF,

*As Trustee in Bankruptcy of F. P. Newport Corporation,  
Ltd., a Corporation, Bankrupt, Petitioner.*

NORMAN A. BAILIE,

RICHARD A. TURNER,  
*Counsel for Petitioner.*

ALLEN T. LYNCH,  
*Of Counsel.*



